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Auditing Standards Board (ASB) meeting, October 26-30, 2009, Phoenix, AZ

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AUDITING STANDARDS BOARD (ASB) MEETING
October 26-30, 2009
Phoenix, AZ

MEETING ATTENDANCE

ASB Members

Harold Monk, *Chair*

Ernie Baugh

Sheila Birch

Jacob Cohen

Walt Conn

Tony Costantini

Charles Frasier

Nick Mastracchio

Andy Mintzer

Thomas Ratcliffe

Randy Roberts

Darrel Schubert

Tom Stemplar

Mark Taylor

Phil Wedemeyer

Stephanie Westington

Art Winstead

Megan Zietsman

Absent:

Jorge Milo (Represented by Brian Richson)

AICPA Staff

Linda Delahanty, *Audit & Attest Standards*

Mike Glynn, *Audit & Attest Standards*

Ahava Goldman, *Audit & Attest Standards*

Hiram Hasty, *Audit & Attest Standards*

Chuck Landes, *Audit & Attest Standards*

Rich Miller, *General Counsel & Trial Board*

Andy Mrakovcic, *Audit & Attest Standards*

David Tolson, *PD-Course Development*

Judith Sherinsky, *Audit & Attest Standards*

Guests and Observers

Abe Akresh, *GAO*

Doug Besch, *SEC*

Rob Chevalier, *KPMG LLP*

Julie Anne Dilley, *PriceWaterhouse Coopers*

John Fogarty, *Deloitte & Touche LLP*

Diane Hardesty, *Ernst & Young LLP*

Jen Haskell, *Deloitte & Touche LLP*

Maria Manasses, *Grant Thornton LLP*

AJ Major, *California Society of CPAs*

Jeff Markert, *KPMG (10/26)*

Susan Menelaides, *McGladrey and Pullen LLP*

Dan Montgomery, *Ernst & Young LLP*

Tammy Mooney, *Thomson Reuters*

Keith Newton, *Grant Thornton LLP*

Mark Nichols, *Mayer Hoffman McCann P.C.*

Brian Richson, *PriceWaterhouse Coopers LLP* (By phone)
Gail Vallieres, *GAO*
H. Steven Vogel, *Wilson Elser Moskowitz Edelman & Dicker LLP*

AGENDA ITEMS PRESENTED AT MEETING

Chair's Report

Mr. Monk, Mr. Landes and Mr. Fogarty provided updates on matters relevant to the ASB. Mr. Schubert provided an update on the activities of the PCOAB SAG.

The ASB approved the highlights of the August 2009 meeting and the September 30, 2009 conference call.

Mr. Landes thanked the outgoing members of the ASB—Mr. Conn, Mr. Costantini, Mr. Mastracchio, Ms. Westington, Mr. Winstead and the outgoing Chair, Mr. Monk—for their years of service.

1. RSI/SI/OI

Mr. Markert, Chair of the RSI/OSI Task Force (Task Force), led a discussion of revisions to the proposed Statements on Auditing Standards, *Required Supplementary Information* (the “RSI SAS”), *Other Supplementary Information in Documents Containing Audited Financial Statements* (the “OI SAS”), and *Supplementary Information in Relation to the Financial Statements as a Whole* (the “IRT SAS”) since the last time those documents were discussed at an ASB meeting (July 2009 for the RSI SAS and OI SAS; and August 2009 for the IRT SAS).

RSI SAS

The ASB discussed the draft document and directed the Task Force to:

- Revise the effective date so that it is consistent with other clarified SAS; however, permitting early application to address concerns raised by the GASB that existing standards are not sufficient.
- Revise the objective to read:

The objectives of the auditor are to perform specified procedures in order to:

- a. describe, in the auditor's report, whether required supplementary information is presented and

- b. communicate therein when some or all of the required supplementary information has not been presented in accordance with guidelines established by a designated accounting standard setter or when the auditor has identified material modifications that should be made to the required supplementary information for it to be in accordance with guidelines established by the designated accounting standard setter.
- In the definition of RSI, state that a designated accounting standard setter considers the information to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context.
- In the definition of designated accounting standard setter, list those bodies designed by AICPA council to establish professional standards with respect to financial accounting and reporting principles pursuant to Rules 202 and 203.
- Revise the report to:
 - Refer to the RSI being presented in accordance with prescribed guidelines as opposed to in accordance with an applicable financial reporting framework.
 - Spell out the limited procedures that the auditor performed by stating, when the auditor has been able to complete the procedures required by the SAS, that “the auditor has applied certain limited procedures to the required supplementary information in accordance with standards established by the American Institute of Certified Public Accountants, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management’s responses to our inquiries, the basic financial statements, and other knowledge we obtained during the audit of the basic financial statements.” The ASB noted that this change should eliminate any confusion as to whether the auditor has an obligation to resolve any open issues with respect to RSI.
 - State, when RSI is omitted, that the auditor’s opinion on the basic financial statements is not affected by the missing information but not state that the entity has not complied with the applicable financial reporting framework because they have omitted the RSI. The ASB was concerned that a statement that the entity has not complied with the applicable financial reporting framework is akin to an opinion.
- Delete the application guidance included in paragraph A2 providing guidance when the auditor is engaged to opine on whether RSI is presented fairly in relation to the financial statements as a whole.

The ASB discussed the statement in the report that the auditor does not express an opinion or any other form of assurance on the information. Members of the ASB stated that the auditor does not express assurance but rather obtains assurance through the procedures performed.

Mr. Markert stated that the language was included at the direction of the ASB and that such language is used throughout the auditing literature and is not unique to the proposed SAS.

Members of the ASB questioned why the procedure from extant AU 558.07 that required the auditor to make additional inquiries if the application of other procedures caused the auditor to believe that the information may not be measured or presented within applicable guidelines is not included in the proposed SAS. Mr. Markert stated that the Task Force concluded that such follow up procedures were appropriately included in the inquiry procedures outlined in paragraph 5 of the proposed SAS.

OI SAS

The ASB discussed the draft document and directed the Task Force to:

- Delete the definitions of required supplementary information and designated accounting standard setter because such terms are defined in the RSI SAS.
- Revise paragraph 13 to clarify that the requirement is applicable when material inconsistencies have been identified in OI obtained subsequent to the release of the auditor's report.
- Revise paragraph 15 to clarify that the entity receives the advice from legal counsel with respect to a potential material misstatement of fact and that the auditor then considers that advice when determining whether the matter is a material misstatement of fact.
- Retain the use of *report release date* as the date before which the auditor should read the OI. ISA 720 uses the date of the auditor's report but the ASB determined that the report release date, as defined in auditing standards generally accepted in the United States, is more appropriate in the U.S. environment.

The ASB discussed whether the SAS should refer to the extant AU sections or whether it should refer to the clarified SASs. The Board determined that since early implementation will be permitted, the SAS should refer to the extant literature and that conforming changes should be made once the clarified SASs become effective.

IRT SAS

Mr. Markert pointed the ASB to the fact that RSI is excluded from the definition of supplementary information in the current draft. The change was made to address concerns raised by the GASB, which does not consider RSI to be supplementary information, that practitioners will be confused if the SAS definition of supplementary information includes RSI. The Task Force determined to exclude RSI from the definition of supplementary information but to state that if an auditor is engaged to issue an IRT opinion on RSI, that the auditor can use the SAS. Mr. Markert noted that auditors are not frequently engaged to issue an IRT report on RSI.

The ASB discussed the draft document and directed the Task Force to:

- Revise the effective date so that it is consistent with the proposed RSI and OI SASs.

- Delete the definitions of other information, required supplementary information, and designated accounting standard setter as those terms are defined in the other proposed SASs.
- Revise the guidance to state that it is inappropriate to issue an opinion on supplementary information when an adverse opinion or a disclaimer of opinion was issued on the financial statements. Such guidance would be consistent with that in the SAS on summary financial statements in which, unless the auditor withdraws from the engagement, the auditor would deny an opinion on the supplementary information.
- Add a paragraph clarifying that the auditor has no responsibility for subsequent events with respect to supplementary information. However, if information comes to the auditor's attention prior to the release of the auditor's report on the financial statements regarding subsequent events that affect the financial statements, the auditor should apply the relevant requirements of AU 560, *Subsequent Events*.
- Require the auditor to obtain an acknowledgement from management that it understands its responsibility to present the supplementary information with the audited financial statements or to make the audited financial statements readily available to intended users of the supplementary information when the supplementary information is not presented with the audited financial statements.
- Require the auditor to obtain a written representation from management when the supplementary information is not presented with the audited financial statements, that management will make the audited financial statements readily available to the intended users of the supplementary information upon issuance of the supplementary information.
- Include application material as to when financial statements are deemed to be readily available, consistent with the guidance in SAS No. 116, *Interim Financial Information*.

Vote to ballot to issue as final SASs

A motion to move to ballot the redrafted risk assessment standards as final standards was unanimously approved by the ASB. It was noted at the time that members have the right to comment on the ballot and if the comments warrant, an opportunity to discuss the comments will be provided.

2. Analytical Procedures

Mr. Conn, Chair of the Analytical Procedures Task Force (Task Force), led a discussion of the materials for proposed SAS *Analytical Procedure*. The proposed SAS represents the redrafting of SAS No. 56, *Analytical Procedures* (AICPA, Professional Standards, vol. 1, AU sec. 329), for clarity and convergence with ISA 520, *Analytical Procedures*.

The ASB directed the Task Force to:

- Revise the objective in paragraph 3(b) as follows, based on a discussion as to whether the objective of performing analytical procedures at the end of the audit is to assist the auditor in (a) forming an overall conclusion about whether the financial statements are consistent with the auditor's understanding of the entity, as stated in ISA 520, or (b) assessing the conclusions reached and in the evaluation of the overall financial statement presentation, as stated in extant AU 329. The ASB concluded that the purpose is to assist the auditor in determining whether additional procedures are needed to obtain sufficient appropriate audit evidence.

To design and perform analytical procedures near the end of the audit that *are intended to corroborate audit evidence obtained during the audit of the financial statements to assist the auditor in drawing reasonable conclusions on which to base the auditor's opinion* ~~when forming an overall conclusion as to whether the financial statements are consistent with the auditor's understanding of the entity.~~

- Revise the documentation requirements in paragraph 8 of the proposed SAS to be consistent with the requirement in extant AU 329.22.
- Revise paragraph A5 to include the following from extant AU 329.03:

An understanding of the purposes of analytical procedures and the limitations of those procedures is also important. Accordingly, the identification of the relationships and types of data used, as well as conclusions reached when recorded amounts are compared to expectations, requires judgment by the auditor.

- Include application material regarding scanning procedures from paragraph A21 of the proposed SAS *Audit Evidence*.

A motion to ballot the proposed SAS for issuance as an exposure draft was unanimously approved by the ASB.

3. AU section 625 Redrafted

Mr. Ratcliffe, Chair of the AU Section 625 Task Force (Task Force), led a discussion of the materials for proposed SAS, *Reports on Application of Requirements of an Applicable Financial Reporting Framework* (proposed SAS). The proposed SAS represents the redrafting of SAS No. 50, *Reports on the Application of Accounting Principles* (AICPA, Professional Standards, vol. 1, AU sec. 625), in accordance with the clarity conventions. There is no ISA that corresponds to AU Section 625.

The ASB directed the Task Force to:

- Revise the effective date to be based on the engagement undertaken rather than the reporting accountant's action of providing the written report or oral advice, such that the proposed SAS will be effective for engagements that begin on or after December 15,

2010.

- Change the term “type of opinion that may be expressed on a specific entity’s financial statements” to “type of report that may be issued on a specific entity’s financial statements” in order to update the use of “opinion” since SAS No. 50 was issued, and to broaden the scope and objective of the proposed SAS to include the request for an opinion regarding the report and not just a transaction.
- Expand the definition of the term “specific transaction” to encompass matters of a business situation (for example, going concern) and not necessarily only mean a discrete transaction.
Divide paragraph 10 subparagraph (b) regarding the requirement for the reporting accountant to establish an understanding with the client into subparagraphs (b) and (c) in order to clarify management’s responsibilities.
- Delete paragraph 12 regarding the requirement for the reporting accountant to comply with AICPA standards in planning and performing the engagement, because this statement applies to all engagements.
- Add a requirement for the reporting accountant to obtain an understanding of the conditions relevant to the type of report that may be issued on a specific entity’s financial statements, in order to reflect the change from “type of opinion...” to “type of report...” made in the proposed SAS.
- Incorporate footnote 1 of a related auditing interpretation to clarify that the reporting accountant is required to consult with the continuing accountant regarding the type of report that would be issued but not regarding a transaction.
- Revised paragraph A6 to clearly state restrictions on the use of the reporting accountant’s written report.

In addition, various editorial changes were made. The ASB deferred the vote to ballot the proposed SAS for exposure until a conference call to be scheduled for November in order to allow the ASB more time to review a revised draft of the proposed SAS that incorporates the discussion held on the final day of the meeting.

4. Risk Assessment

Mr. Schubert, Chair of the Risk Assessment Task Force, led a discussion of the following proposed SASs:

- *Audit Evidence (Redrafted)*
- *Materiality in Planning and Performing an Audit (Redrafted)*
- *Evaluation of Misstatements Identified during the Audit*
- *Planning an Audit (Redrafted)*
- *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement (Redrafted)*
- *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained (Redrafted)*

Mr. Schubert noted that the PCAOB plans to re-expose their version of the risk assessment standards in 2010. The Task Force will review the PCAOB standards when issued and may bring any conforming changes to the ASB standards to the ASB at that time.

The ASB discussed conforming amendments arising from other standards that impact the risk assessment standards. ASB operating procedures require that conforming amendments not be reflected in the standards until the conforming amendment has been subject to due process.

The ASB agreed with the Task Force's recommendations regarding the following conforming amendments:

- To include a conforming amendment to proposed SAS *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement* which will establish a requirement of the auditor to obtain an understanding of the entity's internal audit function. This conforming amendment originated from the IAASB final clarifying changes and was not due to the comment process. Ordinarily the conforming amendment would be exposed with redrafted AU section 322, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements* and then reflected in the proposed SAS; however, that project has been delayed. The Task Force does not believe that this conforming amendment is a significant change that would cause the proposed SAS to be re-exposed.
- To wait to incorporate a conforming amendment to proposed SAS *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained* until proposed SAS *The Confirmation Process* is finalized. The amendment arises from an amendment in the final ISA 505, *External Confirmations* to final ISA 330, *The Auditor's Responses to Assessed Risks*.

- To wait to incorporate a conforming amendment to proposed SAS *Audit Evidence* to reflect the management's specialists content (as ISA 500 does). The management's specialists content will be incorporated into the redrafted SAS *Audit Evidence* via a conforming amendment when AU section 336, *Using the Work of a Specialist*, is redrafted.

A motion to move to ballot the redrafted risk assessment standards as final standards was unanimously approved by the ASB.

5. Internal Control

Mr. Newton, Chair of the Internal Control Task Force, led the ASB in a discussion of a proposed SAS *Communicating Internal Control Related Matters Identified in an Audit* (Redrafted) and related issues. The proposed SAS represents the redrafting of SAS No. 115, *Communicating Internal Control Related Matters Identified in an Audit*, for clarity and convergence with certain aspects of ISA 265, *Communicating Deficiencies in Internal Control to Those Charged with Governance*.

With regard to the issue for consideration, the ASB agreed with the task force to continue to allow the issuance of no-material-weakness letters with use restricted to the intended users identified in extant SAS No. 115. Since such communication is a by-product of the audit, use is restricted to management, those charged with governance, others within the organization, and any specified governmental authority to which the auditor is required to report. This is consistent with the requirements in previous standards and conclusions previously reached by the ASB.

The ASB also directed the task force to:

- Revise the objective in paragraph 6 of the proposed SAS to describe the types of deficiencies the auditor communicates as those that, in the auditor's professional judgment, are of sufficient importance or severity to merit the respective attentions of management and those charged with governance. The reference to "severity" was added as the proposed SAS includes the communication of both significant deficiencies and material weaknesses.
- Clarify the language in the written communications of significant deficiencies and material weaknesses to better describe the auditor's consideration of internal control in an audit of financial statements. In particular, the phrase "there can be no assurance that all deficiencies, significant deficiencies, or material weakness were identified" was eliminated and replaced with the phrase "there may be deficiencies, significant deficiencies, or material weaknesses that were not identified." Similar modifications were made to the illustrative no material weakness letter.

A motion to ballot the proposed SAS for issuance as an exposure draft was unanimously approved by the ASB.

6. Specific Items

Mr. Winstead and Ms. Zietsman led a discussion of the proposed SAS *Audit Evidence - Specific Considerations for Selected Items*. This proposed SAS represents a redrafting of AU section 331, *Inventories*, AU section 332, *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities*, and AU section 337, *Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments*, for clarity and convergence with ISA 501, *Audit Evidence - Specific Considerations for Selected Items*.

At its August meeting the ASB directed the Task Force that requirements in the proposed SAS should address investments other than equity method investments and should refer users to proposed SAS *Group Audits*, which addresses auditing equity method investments. After revising the proposed SAS accordingly, the Task Force considered whether the requirements in extant AU section 332 regarding equity method investments are appropriately addressed by proposed SAS *Group Audits* as drafted or whether conforming changes to proposed SAS *Group Audits* might be needed.

Paragraph A2 of proposed SAS *Group Audits* clearly states that “Investments accounted for under the equity method constitute a component for purposes of this SAS.” Accordingly, the requirements and guidance in the proposed SAS *Group Audits* apply to equity method investments as they would to any other component, including whether or not to make reference to the report of another auditor in the auditor’s report. The ASB agreed with the Task Force’s conclusion that, while the requirements of proposed SAS *Group Audits* are more principles-based, they fully address the requirements in extant AU 332 (see for example, paragraphs 13-14, 24-25, 33-35, 42-47, and 52-56 of proposed SAS *Group Audits*) and that no conforming changes to proposed SAS *Group Audits* are required.

A motion to ballot the proposed SAS for exposure was unanimously approved by the ASB.

7. Consistency

Mr. Montgomery, Chair of the Auditor’s Report Task Force, led a discussion of the materials for Agenda Item 7 Evaluating Consistency of Financial Statements.

With regard to the issues presented, the ASB agreed

- with aligning the proposed SAS with PCAOB Auditing Standard No. 6, *Evaluating Consistency of Financial Statements*.
- to exclude the listed interpretations from the proposed SAS.

The ASB directed the task force to:

- Include application material regarding a change in an accounting entity.
- Include application material regarding when a change in an accounting estimate is inseparable from a change in accounting principle.
- Split paragraph 10 into two paragraphs.

Provide further guidance in paragraph A4 to provide an example of a change in the method of applying an accounting principle.

8. Association With Financial Statements

Mr. Montgomery, Chair of the Auditor's Report Task Force, led a discussion of the materials for Agenda Item 8 *Association With Financial Statements*.

With regard to the issue presented, ASB agreed to include the requirements and application material for summary financial information.

The ASB directed the task force to:

- Revise the scope to state it addresses the auditor's responsibility when the auditor is associated with financial statements and move the definition of association with financial statements to the scope section.
- Expand the guidance on disclaiming an opinion due to lack of independence to relates to all types of entities, not only governmental entities. The task force was asked to consider the guidance in *Government Auditing Standards* and the proposed *Statements on Standards for Accounting and Review Services Compilation of Financial Statements*.

Clarify the section for reporting on audited and unaudited financial statements to better explain why it is included in this proposed SAS and its relationship to the requirements in the proposed *SAS Forming an Opinion and Reporting on Financial Statements*.

9. Service Organizations

Mr. Conn, Chair of the Service Organizations Task Force, led a discussion of a proposed Statement on Standards for Attestation Engagements (SSAE) that would establish standards and provide guidance to service auditors reporting on controls at a service organization. Currently, that guidance is included in AU section 324, *Service Organizations*, along with the guidance for user auditors. The objective of the task force is to align the proposed SSAE with International Standard on Assurance Engagements (ISAE) 3402, *"Assurance Reports on Controls at a Service Organization."* The draft SSAE was aligned with the September 2009 draft ISAE, which the IAASB voted to issue as a final standard at its September 2009 meeting.

The ASB directed the task force to:

- Redraft the last subparagraph of paragraph 2, which addresses combined reports, as application material rather than a requirement.
- Add to exhibit B the following differences between the proposed SSAE and ISAE 3402, The SSAE does not include the requirement contained in paragraph 29 of ISAE 3402 related to concluding that an exception in tests of controls is an anomaly.
- Paragraph 35 of the SSAE contains a requirement related to use of the internal audit function for direct assistance that is not included in ISAE 3402.
- Revise paragraph 53(m) to include a statement about the risk of projecting to future periods any evaluation of the fairness of the presentation of management's description of the service organization's system or conclusions about the suitability of the design of the controls to achieve the related control objectives

A revised draft will be brought back to the ASB at its January 2010 meeting.

10. Omitted Procedures

Ms. Birch, Chair of the Omitted Procedures task force, led a discussion of proposed SAS *Consideration of Omitted Procedures After the Report Date*, which represents the redrafting of AU section 390, *Consideration of Omitted Procedures After the Report Date*, in accordance with the clarity conventions. There is no comparable ISA.

The ASB directed the task force to:

- Add an application paragraph stating that failure to document performance of an audit procedure when documentation is required by generally accepted auditing standards is considered an omitted procedure.
- Replace the term "date of the auditor's report "and other forms of that phrase with "report release date."
- Make certain editorial changes.

A revised draft will be brought to the ASB at its January 2010 meeting.

11. Specialists

Mr. Schubert, Chair of the Specialists Task Force, led a discussion of the proposed SAS *Using the Work of an Auditor's Specialist*, which represents the redrafting of AU section 336, *Using the Work of a Specialist* using ISA 620, *Using the Work of an Auditor's Expert*, as a base.

The ASB discussed the disposition of AU 9336, *Use of Legal Interpretation to Support Management's Assertion That a Transfer of Financial Asset Has Met the Isolation Criterion*. AU 9336 provides guidance to the auditor in obtaining sufficient appropriate audit evidence when an entity has derecognized financial assets in connection with a transfer to another entity. The Task Force recommended that, because the interpretation provides guidance on a narrow, specific issue, it be retained as an interpretation and further concluded that it did not need revision in light of the issuance of SFAS 166. The ASB concluded that AU 9336 needs revision and members volunteered to assist in this project.

A motion to ballot the proposed SAS was unanimously approved by the ASB.

12. Auditor's Report Research

Mr. Taylor provided a brief update about the joint meeting of the IAASB and AICPA Working Groups in October 2009. At that meeting a representative of each research team provided an overview of the research performed and the results obtained, and answered questions that were asked about various aspects of the research. Also at that meeting, members of the IAASB Working Group provided presentations on auditor reporting on financial statements as it has developed in the United Kingdom, Japan, and France. The Working Groups' reports will be brought to the IAASB at its December 2009 meeting and to the ASB at its January 2010 meeting.

The meeting adjourned at 1:00pm.